FILE COPY

No. 384

In the Supreme Court of the United States

October Term, 1939

Guy T. Helvering, Commissioner of Internal Revenue, petitioner

v.

Meredith Wood

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

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OPINION BELOW

The opinion of the Board of Tax Appeals (R. 11–15) is reported in 37 B. T. A. 1065. The *per curiam* opinion of the Circuit Court of Appeals (R. 29) is reported in 104 F. (2d) 1013.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 16, 1939 (R. 29). The petition for a writ of certiorari was filed September 13, 1939, and was granted November 6, 1939 (R. 30). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer in 1931 declared himself trustee of certain property for a period of three years (later extended to five years from the original date) or until the earlier death of either himself or his wife. During the continuance of the trust, the net income was to be paid to the taxpayer's wife, and upon termination the corpus was to remain his or to be transferred to his estate. The question presented is whether the net income of the trust for 1934 was properly included in the taxpayer's gross income.

STATUTE AND REGULATIONS INVOLVED

The pertinent statutes and regulations are printed in the Appendix to the brief for the petitioner in *Helvering* v. *Clifford*, No. 383, this Term, pp. 30–38.

STATEMENT

The facts as stipulated (R. 20–27) and as found by the Board of Tax Appeals (R. 11–12) may be summarized as follows:

On April 8, 1931, respondent, a resident of New York, declared himself trustee for the benefit of his wife of 25 shares of the capital stock of Book of the Month Club, Inc., which he owned (R. 11). The trust was to terminate upon the expiration of three years or upon the earlier death of respondent or his wife. Upon termination the corpus was to be transferred to the respondent to be his own, except that in the case of termination of the trust by his death the property was to go to his executors to be disposed of as part of his estate. A supplementary declaration of trust executed

on March 25, 1932, extended the three-year period for the life of the trust to a five-year period from April 8, 1931 (R. 11).

The declaration of trust provided that all net income from the trust estate should be paid to respondent's wife as and when received (R. 11). Respondent, however, retained full control over the corpus of the estate. Thus, as trustee, he had the power to retain the 25 shares of stock of the Book of the Month Club, Inc., or to sell them at such times and on such terms as he deemed proper (R. 12).[1] In the case of sale, he could invest the proceeds without limitation of laws pertaining to the investment of trust funds. Moreover, he had the power "to determine whether any property or money received or held in trust shall be treated as capital or income, and the mode in which any expense incidental to the execution of the trust is to be borne as between capital and income" (R. 12). He exonerated himself from any liability except for "willful misconduct" (*id*).

Although there were provisions for respondent appointing a substitute trustee (R. 11), respondent at all

[1] This power was, however, qualified by the subsequent provision of the trust deed that the trustee should hold and dispose of the shares of stock of the Book of the Month Club, Inc., subject to the provisions of an agreement dated January 27, 1931, between respondent and one Harry Scherman "to the same extent, as regards said agreement, as though said stock were held and owned by the Settlor as an individual." The agreement referred to provided that if respondent desired to dispose of the stock, he should first offer it for sale to Scherman, that the certificates should bear a suitable legend containing reference to the agreement, and that respondent should not pledge, mortgage, hypothecate, or otherwise encumber any of the shares without the consent of Scherman (R. 12).

times after the creation of the trust and until it terminated on April 8, 1936, remained as trustee and continued to hold the Book of the Month Club, Inc., stock as the sole corpus (R. 12). All dividends paid on the stock were received by the respondent as trustee, deposited by him in a special account, and paid over to his wife by checks drawn to her order and signed by him as trustee (R. 12). No part of the income was distributed to the grantor or accumulated (*id.*).

Respondent duly filed his income-tax return for the year 1934 and paid the tax shown to be due thereon, failing, however, to include the trust income, which amounted to $8,750. The Commissioner increased the taxpayer's income for 1934 by that amount (R. 12). Upon review, the Board of Tax Appeals held that this action of the Commissioner was erroneous and the court below affirmed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In failing to hold that the income involved was taxable to respondent under Section 22 (a) of the Revenue Act of 1934.

(2) In failing to hold that the income involved was taxable to the respondent under Section 166 of the Revenue Act of 1934.

(3) In failing to hold that Article 166–1 of Treasury Regulations 86 constitutes a valid construction of the Revenue Act of 1934 as applied to the facts of this case.

(4) In affirming the decision of the Board of Tax Appeals.

ARGUMENT

This case presents the same issues as those involved in *Helvering* v. *Clifford*, No. 383, present Term, which is to be argued with this case. Reference is made to the Government's brief in the *Clifford* case for the arguments in support of the Government's position here.

1. Although the powers retained by the grantor as trustee were slightly more extensive in the *Clifford* case than they are here,[2] in other particulars the facts of the present case even more strikingly call for the application of Article 166–1 of Regulations 86, promulgated under the Revenue Act of 1934. If the precise period of the trust should be material, it may be noted that while the *Clifford* case involves a five-year trust created during the tax year, here the trust was established in 1931 to last for three years, and was amended in 1932 to last for five years from the original date. It was thus never substantially more than a four-year trust and, at the end of the tax year 1934, it was less than a 16-month trust. Moreover, the taxpayer undertook to reserve the right to determine whether any property or money received by the trust should be treated as capital or income (R. 12). It may be that this reservation was intended to apply only to doubtful items such as extraordinary dividends (cf. *Matter of Osborne*, 209 N. Y. 450; *Equitable Trust Co.* v. *Prentice*, 250 N. Y. 1; *Commissioner* v. *Waterbury*, 97 F. (2d)

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[2] Thus, the respondent had no discretion to accumulate the net income but was required to distribute it to his wife as received and the trust deed contained no provisions exempting the income from being charged for the debts of the wife.

383 (C. C. A. 2d), certiorari denied, 305 U. S. 638) and the retention of ordinary income in capital account might be a violation of the New York law against accumulations (New York Personal Property Law, Section 16). Nevertheless the taxpayer, as a practical matter, might have employed the power thus reserved to retain income for himself, for presumably his wife would not have objected had he done so. Cf. *Rollins* v. *Helvering*, 92 F. (2d) 390, 394 (C. C. A. 8th), certiorari denied, 302 U. S. 763; *Kaplan* v. *Commissioner*, 66 F. (2d) 401 (C. C. A. 1st).

2. Respondent suggested in his brief in opposition to the petition for certiorari that petitioner may not be heard to urge that the trust income is taxable to the respondent under Section 22 (a) of the Revenue Act of 1934 because the point was not raised below. We concede that the Government's brief in the court below expressly waived reliance upon any section other than Section 166. But this is not a case where reversal is asked upon an issue not presented to the lower court or, indeed, upon a theory not argued to that court. As pointed out in our brief in the *Clifford* case (pp. 8–9), Section 166 merely defines with particularity some of the instances in which the grantor of a trust is regarded as in substance the owner of the corpus and therefore as properly taxable on the trust income under Section 22 (a). Whichever section be involved, the factual issues are identical and the legal arguments substantially similar. It would require a remarkably narrow focussing of the court's attention if it were able to decide the issue under Section 166 without simultaneous consideration of the effect of the provisions of Section

22 (a). The similarity, both in principal and in consequences, of the tax theory underlying Sections 22 (a) and 166 is illustrated by the fact that the Board,[3] the Government's brief in the Circuit Court of Appeals,[4] and the authority upon which the court below decided the case,[5] each consider the argument under Section 22 (a).

We have no quarrel with the rule that reversal cannot ordinarily be sought upon a *ground* not urged below.

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[3] The opinion in two places answers arguments that seem necessarily based upon Section 22 (a). It states that "the trust here in question was not established to discharge a legal obligation of the grantor," so that *Douglas* v. *Willcuts*, 296 U. S. 1, is inapplicable (R. 14). Again, it concludes that "the petitioner did not own that income nor did it remain his in substance" (R. 14–15).

[4] The brief read (pp. 13–14):

"Viewed in this light, it is thought that the instant case is substantially similar to cases holding that the assignment of future income from services to be performed or property retained by the assignor does not relieve him from tax. *Lucas* v. *Earl*, 281 U. S. 111; *Burnet* v. *Leininger*, 286 U. S. 136; see *Reinecke* v. *Smith*, 289 U. S. 172, 177; cf. *Matchette* v. *Helvering*, 81 F. (2d) 73 (C. C. A. 2d). It is thought that the taxpayer here remained in substance the owner of the trust property so that the tax in the instant case was properly imposed upon him by virtue of such ownership (see *Blair* v. *Commissioner*, *supra*, p. 12; cf. *Poe* v. *Seaborn*, 282 U. S. 101) even though he may have assigned certain income rights with respect thereto. See *Reinecke* v. *Smith*, *supra*."

[5] *United States* v. *First National Bank of Birmingham*, 74 F. (2d) 360 (C. C. A. 5th). The opinion states (p. 362):

"* * * The thing granted being the estate or property interest which produced the income in question, not future income earned by the grantor or settlor or produced by property which he continued to own, rulings such as those made in the cases of *Lucas* v. *Earl*, 281 U. S. 111, 50 S. Ct. 241, 71 L. Ed. 731, and *Burnet* v. *Leininger*, 285 U. S. 136, 52 S. Ct. 345, 76 L. Ed. 665, are not applicable."

But that salutary rule of judicial administration cannot, of course, be pressed so far as to preclude new supporting reasons for the position taken by the petitioner; any such rule would require, in effect, that this Court decide its important issues upon briefs and arguments which have only literary differences from those presented below. The question is plainly one of degree. Where no injustice is done the respondent, he cannot ask this Court to sanction an erroneous result through a pedantic adherence to what might be called the canons of appellate pleading. Plainly enough, in this case, respondent will not be prejudiced if Section 22 (a) is considered by this Court for the first time. Compare *Helvering* v. *Gregory,* 69 F. (2d) 809 (C. C. A. 2d) affirmed, *Gregory* v. *Helvering,* 293 U. S. 465; *Erie R. Co.* v. *Tompkins,* 304 U. S. 64.

CONCLUSION

The judgment of the court below should be reversed.

Respectfully submitted.

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